

Message Text

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PAGE 01 CAIRO 05472 01 OF 04 221740Z

44

ACTION TRSE-00

INFO OCT-01 NEA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-07

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R 221330Z APR 76

FM AMEMBASSY CAIRO

TO SECSTATE WASHDC 2315

LIMITED OFFICIAL USE SECTION 1 OF 4 CAIRO 5472

E.O.11652: N/A

TAGS: EINV, BGEN, USEGJC, EG

SUBJECT: GOE REPORTS ON GOODYEAR AND MICHELIN TIRE PROJECTS

REF: CAIRO 5266

1. SUMMARY. PRINCIPAL POINTS OF TWO STUDIES ON EGYPTIAN TIRE PROJECT WHICH WERE GIVEN TO AMBASSADOR BY MINECON SHAFEI ARE OUTLINED. FIRST STUDY PREPARED BY INVESTMENT AND FREE ZONE AUTHORITY IS EXTREMELY HOSTILE TO GOODYEAR PROPOSAL AND COULD BE INTERPRETED AS AN ATTACK UPON WHOLE CONCEPT OF EGYPTIAN OPEN DOOR POLICY. SECOND STUDY COMPARES GOODYEAR AND MICHELIN PROPOSALS AND ITS TONE IS MUCH MORE SENSIBLE. IT RECOMMENDS, HOWEVER, THAT GOE SEEK FEASIBILITY STUDY AND MORE DETAILS FROM MICHELIN BEFORE MAKING DECISION. END SUMMARY.

2. AS REPORTED REF, AMBASSADOR MET WITH MINECON SHAFEI ON APRIL 19. GOODYEAR PROJECT WAS DISCUSSED AND HE WAS GIVEN GOE REPORTS ON GOODYEAR PROJECT AND COMPARISON OF MICHELIN AND GOODYEAR PROJECTS. THIS CABLE SUMMARIZES INFORMAL TRANSLATIONS OF THESE TWO REPORTS, (FULL TEXT WILL BE SENT BY AIRGRAM) AND REPORTS PRESS COMMENTARY ON
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PAGE 02 CAIRO 05472 01 OF 04 221740Z

TIRE PROJECT PLUS EMBASSY COMMENTS ON PROJECT STATUS.

3. DRAFT REPORT ON GOODYEAR PROJECT PREPARED BY DR. GOUDA
ABDUL KHALEQ (CONSULTANT TO INVESTMENT AND FREE ZONE
AUTHORITY) STATES:

(A) DEBT EQUITY RATION WILL BE QUOTE EXTREMELY HIGH UNQUOTE.
IN THIRD YEAR OF PROJECT, RATIO WILL BE 4.5 TO 1.

(B) DISCUSSION OF IMPORT SUBSTITUTION. (AS THIS IS KEY
SECTION OF REPORT, FULL TEXT FOLLOWS). QUOTE PROPOSED PROJECT
IS BASED ON REPLACEMENT OF TIRE IMPORTS AND IT DOES NOT MEET
ITS OWN REQUIREMENTS OF FOREIGN CURRENCY. IT IS WELL KNOWN
TO WHAT EXTENT SUCH A PROJECT IS IMPORTANT TO NATIONAL ECONOMY
FOR TIRES ARE ONE OF ESSENTIAL COMMODITIES TO INCREASE PRODUCTION
CAPACITY WHETHER IN AGRICULTURE, INDUSTRY, TRANSPORT OR
COMMUNICATIONS. HOWEVER, THE IMPORTANT QUESTION IS: WILL
EGYPTIAN ECONOMY PAY TO OBTAIN THESE TIRES A COST EQUAL TO
ADVANTAGES IT WILL ENJOY? THIS QUESTION IS OF EXTREME IMPORTANCE
AND WE SHALL TRY TO ANSWER IT TAKING INTO ACCOUNT THAT FOREIGN
CURRENCY IS CONSIDERED AN EXTREMELY RARE RESOURCE IN EGYPTIAN
ECONOMY, AND THAT PRIMARILY TARGET OF NATIONAL ECONOMY
POLICY TO PRODUCE THE LARGEST POSSIBLE AMOUNT OF FOREIGN
CURRENCY.

THE GOODYEAR STUDY SAID (PAGE 52) THAT PROJECT WILL REALIZE
YEARLY NET PROFIT OF FOREIGN CURRENCY ESTIMATED AT TEN
MILLION DOLLARS. FOLLOWING IS A BREAKDOWN OF THIS SUM.
TOTAL YEARLY FOREIGN CURRENCY REQUIREMENTS ARE ESTIMATED AT
27.9 MILLION DOLLARS. PROJECT SHALL OBTAIN 9.6 MILLION DOLLARS
FROM EXPORTS. THEREAFTER NET YEARLY REQUIREMENTS OF
FOREIGN CURRENCY WILL BE WITHIN LIMITS OF 18.3 MILLION DOLLARS.
STUDY MADE BY GOODYEAR ESTIMATES THAT LOCALLY PRODUCED
TIRES WILL SAVE 28.4 MILLION DOLLARS IF COMPARED WITH IMPORTS
(C.I.F.) FROM ABROAD. HENCE, IF VALUE OF IMPORTS IS I AND
THE VALUE OF LOCAL PRODUCTS IS L, THEN L MINUS I EQUALS 28.4
MILLION DOLLARS.

STUDY DOES NOT EXPLAIN HOW THIS SUM OF FOREIGN CURRENCY WAS
ESTIMATED. WE NOTICE THE FOLLOWING:

IF TIRES WERE LOCALLY PRODUCED, YEARLY REQUIREMENTS OF FOREIGN
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PAGE 03 CAIRO 05472 01 OF 04 221740Z

CURRENCY REACH (ACCORDING TO ASSESSMENTS CONCERNING SIXTH
YEAR) 27.9 MILLION DOLLARS. THIS MEANS THAT OBTAINING THIS
PRODUCTION FROM ABROAD WOULD INEVITABLY BE COSTLY ACCORDING
TO FIGURES QUOTED IN STUDY MADE BY GOODYEAR.

IMPORTS SAVED BEFORE (I EQUALS L PLUS 28.4 MILLION DOLLARS)

DEDUCTION OF INTERMEDIATE (EQUALS 27.9 PLUS 28.4 EQUALS

IMPORTS 56.3 MILLION DOLLARS

YEARLY PRODUCTION IN THE SIXTH YEAR REACHES 590,000 TIRES.
THUS, THE PRICE OF ONE TIRE IF IMPORTED IS (56,300 THOUSAND
DOLLARS DIVIDED BY 590,000 TIRES) 95 DOLLARS WHICH IS A
FANTASTIC FIGURE, EVEN IF WE TAKE INTO ACCOUNT LARGE SIZES
OF TIRES. IN OTHER WORDS, WE BELIEVE THAT FOREIGN CURRENCY
WHICH PROJECT WILL SAVE EVERY YEAR IS EXAGGERATED AS A
RESULT OF QUOTING EXAGGERATED PRICES FOR TIRES IMPORTS.
UNQUOTE

(C) GOODYEAR PROPOSAL CONTRADICTS PARA 5 ARTICLE 2 OF
LAW 43 BY REQUESTING THAT FUTURE INCREASES IN CAPITAL
AUTOMATICALLY ENJOY BENEFITS OF LAW 43.

(C) COMPLAINTS THAT COMMISSIONS REQUESTED BY GOODYEAR
FOR MACHINERY AND EQUIPMENT IMPORTS (3 PERCENT), ENGINEERING
FEES (7 AND ONE-HALF PERCENT) AND LOCALLY MDE PRODUCTS AS
TECHNICAL AID (2 AND ONE-HALF PERCENT) SEEM HIGH CONSIDERING
GOODYEAR'S 50 PERCENT EQUITY OWNERSHIP OF PROJECT.

(3) COMMENT THAT PERIOD OF CUSTOMS PROTECTION SHOULD
BE LIMITED TO SPECIFIC PERIOD.

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PAGE 01 CAIRO 05472 02 OF 04 221626Z

44

ACTION TRSE-00

INFO OCT-01 NEA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-07

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R 221330Z APR 76

FM AMEMBASSY CAIRO

TO SECSTATE WASHDC 2316

LIMITED OFFICIAL USE SECTION 2 OF 4 CAIRO 5472

(F) REPORT DISPUTES GOODYEAR CONCLUSION THAT QUOTE RATE OF PROFIT TO TOTAL INVESTMENT REACHES 17.4 PERCENT UNQUOTE. INSTEAD, IT ASSERTS THAT RATE OF PROFIT WILL AVERAGE 55 PERCENT DURING FIRST 10 YEARS OF PROJECT AND THAT INVESTORS WILL RECOVER THEIR CAPITAL IN LESS THAN TWO YEARS. (EMB COMMENT: IT APPEARS THAT AUTHOR PERHAPS HAS COMPUTED RATE OF RETURN AGAINST EQUITY CAPITAL WITHOUT TAKING INTO CONSIDERATION DEBT STRUCTURE. DIATRIBE FOLLOWS THAT THESE PROFITS WOULD BE QUOTE UNJUSTIFIABLE BURDEN ON EGYPTIAN ECONOMY UNQUOTE.)

(G) IT MAKES NON-SEQUITUR OBJECTION TO GOODYEAR REQUEST THAT 7 MILLION DOLLARS IN HARD CURRENCY BE MADE AVAILABLE PER YEAR AND TRANSFERRED AT THE MOST FAVORABLE RATE OF EXCHANGE OF DATE OF REMITTANCE. AUTHOR NOTES THAT QUOTE THIS SUM IS SUBJECT TO INCREASE ACCORDING TO THE RISE IN PRICES WHICH GIVES RISE TO THE FOLLOWING QUESTION. ISN'T IT BETTER THAT THIS SUM BE USED TO STEP UP PRODUCTION CAPACITY OF THE TRANSPORT AND ENGINEERING COMPANY? UNQUOTE

(H) GOODYEAR'S REQUEST THAT IT BE PERMITTED TO INCREASE ITS CAPITAL ACCORDING TO CIRCUMSTANCES IS REBUTTED WITH FOLLOWING ARGUMENT: SINCE GOODYEAR IS ONE OF BIGGEST AND MOST ADVANCED LIMITED OFFICIAL USE

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PAGE 02 CAIRO 05472 02 OF 04 221626Z

COMPANIES IN THIS FIELD, QUOTE THERE IS REAL JUSTIFICATION TO ENTERTAIN FEARS CONCERNING FUTURE OF LOCAL INDUSTRY. UNQUOTE. FURTHER, SINCE PROJECT WILL PRODUCE TIRES FOR MILITARY USE AND WILL CONTROL DISTRIBUTION, NATIONAL SECURITY MIGHT BE HARMED, PARTICULARLY BECAUSE GOODYEAR WILL HAVE GUARANTEED RIGHTS TO MANAGE THIS PROJECT.

(I) TIRES PRODUCED BY GOODYEAR WILL BE SOLD FOR 10-12 PERCENT MORE THAN TIRES PRODUCED BY TRANSPORT AND ENGINEERING COMPANY.

(J) OBJECTION THAT GOODYEAR WILL BE PURCHASING FUEL AND ELECTRICITY FOR EGYPTIAN POUNDS. ARGUMENT IS THAT GOODYEAR RECEIVING CHEAP LOCAL PRICES FOR THESE IMPUTS WHEREAS THEY SHOULD BE PAYING WORLD PRICES. (ARGUMENT IS MADE ON BASIS OF SHADOW PRICING WHICH APPEARS TO HAVE NO RELEVANCE WHATSOEVER TO GOODYEAR PROPOSAL. IMPLICATION, HOWEVER, IS THAT PERMITTING A FOREIGN COMPANY TO OPERATE IN EGYPT WITH SIMILAR BENEFITS TO THOSE ENJOYED BY EGYPTIAN COMPANIES IS RIPPING OFF EGYPTIAN ECONOMY.)

(K) REPORT CONCLUDES THAT QUOTE PARTY WHICH WILL TRULY BENEFIT...WILL BE GOODYEAR AT EXPENSE OF EGYPTIAN ECONOMY IN GENERAL AND THE TRANSPORT AND ENGINEERING COMPANY IN PARTICULAR UNQUOTE. NOTABLE BENEFITS ENJOYED BY

GOODYEAR WILL INCLUDE (1) ENTRY INTO EGYPTIAN MARKET WITHOUT PAYING CUSTOMS AND IT WILL QUOTE EVEN UNQUOTE ENJOY TARIFF PROTECTION WITHIN EGYPT. (2) HIGH PROFITS (3) CONTROL OF PROJECT MANAGEMENT WHICH ENTIALS EMERGENCY OF NEW ECONOMIC POWER WITH SUBSEQUENT POSSIBILITY OF CONTROLLING INDUSTRY VITAL TO NATIONAL ECONOMY. (4) GETTING SALES COMMISSION FOR TECHNICAL ASSISTANCE IN WHICH THE VENDER HIMSELF OWNS 50 PERCENT OF THE EQUITY.

() FINAL SENTENCE OF REPORT IS AS FOLLOWS: QUOTE UNDOUBTEDLY, STUDY OF GOODYEAR PROJECT CASTS LIGHT ON EXTENT OF INJUSTICE IMPLIED IN INTRODUCTION OF TECHNOLOGY THROUGH THE EXECUTION OF JOINT PROJECTS UNQUOTE.

4. PROJECT COMPARISON REPORT PREPARED BY MAREI AHMED MAREI.
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PAGE 03 CAIRO 05472 02 OF 04 221626Z

(A) PROJECT DESCRIPTION. MICHELIN WILL ESTABLISH A TRUCK TIRE PLANT TO PRODUCE 250,000 TIRES (60 TONS DAILY) WHICH EVENTUALLY WILL EXPAND TO 1.2 MILLION TIRES ANNUALLY. TOTAL INVESTMENT WILL BE LE 27 MILLION OF WHICH LE 7 MILLION (26 PERCENT) WOULD BE EQUITY. EQUITY PARTNERS WOULD BE MICHELIN (50 PERCENT), GOE (35 PERCENT) AND ARAB INVESTORS (15 PERCENT). FIRST STAGE LABOR FORCE WOULD BE ONE THOUSAND WORKERS WITH EMPLOYMENT REACHING 2250 AFTER EXPANSION. PROJECTED SALES ARE LE 22 MILLION AND 50 PERCENT OF PRODUCTION WILL BE EARMARKED FOR EXPORT TO MIDDLE EAST AND EUROPE. PROJECT WILL GENERATE SUFFICIENT FOREIGN CURRENCY TO MEET REQUIREMENTS FOR RAW MATERIALS PURCHASES AND PAYMENT FOR TECHNICAL SERVICES.

(B) REPORT NOTES THAT MICHELIN HAS NOT SUBMITTED COMPREHENSIVE FEASIBILITY STUDY. AFTER MENTIONING THAT EXPORT PRICES WOULD CERTAINLY BE LESS THAN LOCAL PRICES, IT IS NOTED THAT MICHELIN HAS NOT STATED THE AMOUNT OF PROCEEDS WHICH WOULD ACCRUE FROM EXPORT, BUT HAS ONLY STATED THAT 50 PERCENT OF PRODUCTION WOULD BE EXPORTED. FURTHER, MICHELIN HAS NOT STATED THEIR ANNUAL REQUIREMENTS FOR FOREIGN EXCHANGE, BUT SIMPLY MADE ASSURANCES THAT THE EXPORTS PROCEEDS WOULD BE SUFFICIENT TO PAY FOR RAW MATERIALS AND TECHNICAL SERVICES. QUOTE THERE IS NO DEFINITE OR CLEAR-CUT STATEMENT (FROM MICHELIN) AFFIRMING THAT SUCH PROCEEDS WOULD BE SUFFICIENT FOR THE COMPANY'S FOREIGN EXCHANGE NEEDS INCLUDING PAYMENTS OF PRINCIPLE AND INTEREST ON LOANS, PROFIT REMITTANCES AS WELL AS

SALARIES OF FOREIGN PERSONNEL AND TRAINING
EXPENSES ETC. UNQUOTE. NOTING THAT FOREIGN EXCHANGE
COSTS FOR SIMILARLY SIZED GOODYEAR PROJECT ARE
ESTIMATED AT ABOUT \$30 MILLION, IT IS EMPHASIZED THAT
QUOTE IT WILL BE NECESSARY TO ASCERTAIN ADEQUACY OF EXPORT
PROCEEDS TO SATISFY COMPANY REQUIREMENTS FOR FOREIGN
EXCHANGE. UNQUOTE.

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PAGE 01 CAIRO 05472 03 OF 04 221750Z

44

ACTION TRSE-00

INFO OCT-01 NEA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-07

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02

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PRS-01 SS-15 NSC-05 L-03 /080 W

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R 221330Z APR 76

FM AMEMBASSY CAIRO

TO SECSTATE WASHDC 2317

LIMITED OFFICIAL USE SECTION 3 OF 4 CAIRO 5472

(C) EMBASSY COMMENT: IN ARGUMENT PARA (B),
MAREI IMPLIES THAT EXPORTS OF 50 PERCENT OF PRODUCTION
MAY NOT BE SUFFICIENT TO GENERATE FOREIGN EXCHANGE
REQUIREMENTS OF MICHELIN PROJECT. ON SURFACE IT
APPEARS THAT HE HAS STRONG ARGUMENT. TOTAL PRODUCTION
WILL BE VALUED AT LE 22 MILLION. FOREIGN EXCHANGE
REQUIREMENTS ARE ABOUT LE 12 MILLION (AT OFFICIAL
EXCHANGE RATE) WHICH IS MORE THAN HALF THE VALUE OF
PRODUCTION. FURTHER, EXPORT PRICES WILL BE LOWER
THAN DOMESTIC PRICES. THUS, HE IMPLIES THAT MICHELIN
PROJECT WOULD HAVE FOREIGN EXCHANGE SHORT-FALL OF
SEVERAL MILLION EGYPTIAN POUNDS. END COMMENT.

(D) AFTER INDICATING THAT ALL OF GOE'S DISCUSSIONS
WITH OTHER MAJOR TIRE PRODUCERS HAVE SHOWN THAT
EXPORT PROSPECTS ARE LIMITED DUE TO INTERNATIONAL
COMPETITION AND HIGH COST OF PRODUCTION OF EGYPTIAN

TIRES BECAUSE OF REQUIREMENT THAT FOREIGN EXCHANGE BE OBTAINED THROUGH COLLATERAL MARKET, HE REMINDS THAT IT IS NECESSARY TO INSURE SOUNDNESS OF MICHELIN MARKETING PLANS.

(E) MICHELIN'S ASSERTION THAT ITS METAL TIRE IS LIMITED OFFICIAL USE

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PAGE 02 CAIRO 05472 03 OF 04 221750Z

THE BEST IN THE WORLD AND HAS TWICE DURABILITY OF OTHER TIRES APPARENTLY IS ACCEPTED.

(F) MICHELIN HAS NOT CLEARLY SPECIFIED ITS CHARGES FOR TECHNICAL ASSISTANCE, ENGINEERING FEES, OR COMMISSIONS ON PURCHASES.

(B) MICHELIN HAS OFFERED TECHNICAL ASSISTANCE TO TRANSPORT AND ENGINEERING COMPANY FOR RADIAL TEXTILE TIRES ONLY (NOT METALLIC) THROUGH ONE OF ITS SUBSIDIARIES FOR 5 MILLION FRENCH FRANCS. THIS OFFER APPEARS TO BE CONDITIONAL IN THAT THE TRANSPORT AND ENGINEERING COMPANY WOULD BE REQUIRED TO PURCHASE RADIAL TIRE MACHINES FROM THE SUBSIDIARY AT ESTIMATED COST OF QUOTE 23 MILLION FRENCH FRANCS FOR THE PRODUCTION OF 1,000 TIRES DAILY OF 17 MILLION FRENCH FRANCS FOR THE PRODUCTION OF 15,000 TIRES DAILY. UNQUOTE.

(H) MICHELIN HAS NOT ASKED FOR SPECIAL TAX EXEMPTIONS OR CUSTOMS PROTECTION OF LOCAL PRICING OF DISTRIBUTION SYSTEMS OR ASKED FOR FOREIGN EXCHANGE QUOTA. (PRESUMABLY, GOODYEAR PROPOSAL INCLUDES ALL OF THESE ITEMS.)

(I) SUMMARY TABLES.

(1) TECHNICAL STANDARD. ACCEPTS MICHELIN'S TECHNICAL SUPERIORITY OVER GOODYEAR.

(2) PRODUCTIVITY. GOODYEAR PRODUCTION WILL NEARLY SATISFY LOCAL MARKET REQUIREMENTS.

(3) EXPORTS.
GOODYEAR 18 PERCENT MICHELIN 50 PERCENT

(4) QUANTITIES FOR LOCAL MARKET.
GOODYEAR 515 THOUSAND MICHELIN 125 THOUSAND

(J) CONCLUSION: QUOTE NUMEROUS RESERVATIONS IN GOODYEAR'S PROPOSAL, COULD ULTIMATELY LEAD TO FAILURE IN CONCLUDING AN AGREEMENT FOR THE ESTABLISHMENT OF THE LIMITED OFFICIAL USE

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PAGE 03 CAIRO 05472 03 OF 04 221750Z

JOINT COMPANY. ON THE OTHER HAND, MICHELIN PROPOSAL IS SOMEWHAT AMBIGUOUS AND NOT CLEAR ENOUGH TO JUSTIFY TAKING A DECISION. THEREFORE, IT IS APPROPRIATE TO EXPEDITIOUSLY SUMMON REPRESENTATIVES OF COMPANIES IN ORDER TO THRASH OUT AND ELUCIDATE THE FOUNDATIONS UPON WHICH JOINT COMPANY COULD BE ESTABLISHED. UNQUOTE. REPORT FINALLY RECOMMENDS THAT GOE ASK MICHELIN TO PREPARE FEASIBILITY STUDY WITHIN SPECIFIC TIME LIMITS.

5. PRESS COMMENTARY. ARTICLE APPEARED IN AL AKHBAR ON APRIL 20 WHICH FEATURED INTERVIEW WITH MINECON SHAFEI ON REASONS MICHELIN PROJECT HAD BEEN SELECTED OVER GOODYEAR. SHAFEI REPORTEDLY SAID THAT EXPERTS OF MINECON, GENERAL ORGANIZATION FOR INDUSTRIALIZATION AND BOARD OF INVESTMENT AND FREE ZONES AUTHORITY HAVE COLLECTIVELY APPROVED FEASIBILITY OF MICHELIN OFFER FOR THREE PRINCIPLE REASONS: (A) NO CONVERTIBLE CURRENCY COSTS WILL BE INCURRED BY THE STATE; (B) IT CONTRIBUTES TO AN INCREASE OF PRODUCTIVE CAPACITY OF MISR TIRE CO. TO MEET REQUIREMENTS OF LOCAL MARKET FOR VEHICLE CARS; AND (C) IT PRESENTS AN ADVANCED LEVEL OF TECHNOLOGY. SHAFEI CONTINUED TO EXPLAIN THAT GOE AUTHORITIES HAD TRIED TO GET GOODYEAR TO INCREASE THE PERCENTAGE OF PRODUCTION DEVOTED TO EXPORTS BUT THAT GOODYEAR HAD REFUSED. FURTHER, IT WAS IMPOSSIBLE FOR EGYPT TO MAKE THE FINANCIAL COMMITMENTS REQUIRED FOR THE GOODYEAR PROJECT AND GOODYEAR HAD REFUSED TO HELP INCREASE PRODUCTIVE CAPACITY OF LOCAL TIRE PLANT.

6. COMMENT. RESUSCITATION OF GOODYEAR PROJECT WILL BE VERY DIFFICULT. IT WOULD APPEAR THAT MINECON SHAFEI HAD NOT FULLY DIGESTED EITHER OF STUDIES ON TIRE PROJECT WHICH HE GAVE TO AMBASSADOR IN VIEW OF THEIR CONTENTS. REPORT PREPARED BY DR. KHALEQ REVEALS NO COMPREHENSION OF CONCEPT OF IMPORT SUBSTITUTION. THIS REPORT ALSO RAISES SERIES OF HOARY PROBLEMS ABOUT ENTIRE INVESTMENT CLIMATE. IT CLEARLY REVEALS NATURE OF OPPOSITION TO SADAT'S OPEN DOOR ECONOMIC POLICIES EVEN WITHIN INVESTMENT AND FREE ZONE AUTHORITY, WHOSE REPORT

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PAGE 04 CAIRO 05472 03 OF 04 221750Z

ON GOODYEAR PROJECT PULLED OUT ALMOST EVERY CONCEIVABLE CHARGE TO DISCREDIT GOODYEAR AND FOREIGN

INVESTMENT. IT MUST BE REFUTED IN DETAIL.

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PAGE 01 CAIRO 05472 04 OF 04 221754Z

44

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R 221330Z APR 76

FM AMEMBASSY CAIRO

TO SECSTATE WASHDC 2318

LIMITED OFFICIAL USE SECTION 4 OF 4 CAIRO 5472

7. MAREI AHMED MAREI'S REPORT IS MUCH MORE BALANCED AND HAS SENSIBLE TONE. HE QUESTIONS, JUST AS WE DO, ABILITY OF MICHELIN TO COMPETITIVELY EXPORT 50 PERCENT OF THEIR EGYPTIAN PRODUCTION. HE ALSO INDIRECTLY RAISES INTERESTING POINT ABOUT WHETHER MICHELIN PROJECT, EVEN IF IT ACHIEVES EXPORT GOALS, WILL BE SELF-SUFFICIENT IN FOREIGN EXCHANGE. HIS RECOMMENDATION THAT MICHELIN BE ASKED TO PREPARE FEASIBILITY STUDY WAS, AS WE HAVE SEEN ACCEPTED. HOWEVER, FROM TECHNICAL AND FINANCIAL POINT OF VIEW WE DO NOT BELIEVE THAT MAJOR ISSUES OF SUBSTANCE HAVE BEEN RESOLVED. IN THIS REGARD, THESE PARTICULAR ISSUES MAY HAVE BEEN OUTWEIGHED BY POLITICAL CONSIDERATIONS.

8. FURTHER COMMENTS AND RECOMMENDATIONS ON POSSIBLE COURSES OF ACTION FOR GOODYEAR WILL FOLLOW SEPTTEL. AMBASSADOR EXPECTS TO HOLD FURTHER CONVERSATIONS WITH SHAFEI ON THIS SUBJECT APRIL 22.
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